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SUBJECT: Egypt: Tax Reform Continues As Revenues Meet Lowered Expectations

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¶1. (SBU) KEY POINTS

-- Egypt's Tax Commissioner expects the implementation of the new real estate law to proceed without significant alterations.

-- He claims that much of the public resistance to filing property declarations is rooted in people's desire to maintain the secrecy of their wealth, which has traditionally been held in real estate.

-- Egypt's tax revenue is down substantially from last year, but appears to be on track to meet budgetary expectations.

-- No new tax laws are expected to be presented to the Parliament prior to the upcoming parliamentary and presidential election cycles, but the Tax Authority will continue working to automate its systems and improve data collection in support of expanding and deepening the tax base.

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Real Estate Tax Law Unchanged  
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¶2. (SBU) In a February 7 meeting, Ashraf Al Arabi, Egypt's Deputy Minister of Finance for Tax Policy and Commissioner of the Egyptian Tax Authority, told us that he was confident that implementation of the real estate tax would go ahead as scheduled (ref A). He acknowledged the negative publicity surrounding the registration of properties, which had "created anxiety" among taxpayers. Despite this, he was confident that the plan would move forward with "no official changes." Referencing President Mubarak's comments last month, in which Mubarak suggested he might advocate for a progressive tax structure or possible homestead exemption, Al Arabi told us that the real estate tax situation had subsequently "been clarified to the President" and that Mubarak supported leaving the law intact.

¶3. (SBU) Al Arabi explained that there were a number of reasons for the public outcry against the real estate tax: Since most income

tax is paid through direct payroll deductions, the vast majority of taxpayers in Egypt have no experience dealing directly with the Tax Authority (Note: for taxpayers who have income tax deducted by their employer, there is no annual tax filing requirement. End note). His office, Al Arabi said, deals directly with only about 3.1 million corporate and self-employed tax filers. The new real estate tax registration requirement will now bring 40 million Egyptians in contact with the Tax Authority. He added that part of the outcry relates to people's resistance to disclosing their real estate holdings. According to Al Arabi, Egyptians have traditionally used real estate as their primary store of wealth, and people do not want information on their assets disclosed to the government or made public. This echoes his public comments suggesting that once holdings are declared, some people, particularly government employees, might find it difficult to explain where they got the resources to buy the properties they own.

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#### Revenues on Track, But Reforms Have Slowed

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¶4. (SBU) In Egypt's fiscal 2009/10 budget, tax revenues are projected at LE 145.5 billion (US\$26.5 billion) down 10.8% from last year. Actual tax revenues during the first six month of the

fiscal year (July-December) are down 8.5%. Tax revenues from the Egyptian General Petroleum Corporation (EGPC), the state-owned oil company, which were budgeted to drop 45% due to lower world oil prices are actually running about 6% lower than the already reduced budget forecast. With the exception of the EGPC revenue, Al Arabi asserted that revenues will meet projections and that the shortfall from EGPC taxes could be made up by better than expected revenues from taxes on treasury bills and bonds, which are taxable for the first time this year.

¶5. (SBU) Al Arabi said that the onset of the financial crisis in 2008 stalled well-advanced plans to replace the sales and consumption taxes with a unified Value Added Tax (VAT), and that he did not envision much progress in that area until after the 2010 Parliamentary elections and the 2011 Presidential election. He explained that some articles of the new law might still be passed even if the complete reform could not yet be addressed.

¶6. (SBU) Al Arabi told us that tax collection procedures had improved substantially, particularly for corporate taxpayers, and that the GOE had made progress in closing loopholes and incentives for tax evasion. Tax preparers are now jointly liable with their clients for information provided in tax returns. This has removed much of the incentive for accountants to evade rather than comply with the law. He said that the Tax Authority still has major compliance issues with small and mid-sized businesses, many of whom deal strictly in cash and lack many of the formal legal and accounting structures that would aid in tax collection. He estimated that the government's tax revenues currently amount to 13-14% of GDP, but that by taxing the large informal economy, this could rise to 20%.

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#### Improvements in Data Collection Are the Key

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¶7. (SBU) El Arabi, who has been in his current position for a little less than three years, comes from a private sector accounting and auditing background. He stated that the reorganization he has done in the Tax Authority has proven difficult. He pointed to the example of consolidating the 64 "tax regions" that had previously existed into the 15 regions that exist today. This consolidation removed a great deal of redundant bureaucracy, but also limited promotion possibilities for Tax Authority employees. He said successes in automation and segmentation meant that the Tax Authority was "no longer a soft administration" within the government.

¶8. (SBU) Al Arabi credited US assistance through USAID with much of the progress in both automation and training within the Tax Authority. He added that further progress in tax collection will be reliant on the quality of information gathered and the proper analysis of that data. He said he plans to create an "internal inspection unit" and will build an "intelligence center" for data collection and verification.

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Comment  
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¶9. (SBU) Lower revenues and higher budget deficits remain a worry both for Egyptian policy makers and the rest of the financial community. Egypt does, however, appear to be on track to meet its tax revenue projections for the year. As reported septel, the spending side of the equation is less promising, as greater than expected expenditures on subsidy programs and fiscal stimulus packages continue to put a strain on the overall budget. Public discontent with many of the measures proposed by Finance Minister Youssef Boutros Ghali, including the real estate tax, continues to

be reflected in the press and among some members of the Parliament. However, all indications are that Boutros Ghali continues to have the support of the President, and the much needed fiscal reforms he has been promoting will continue, though perhaps at a slower pace.  
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